

**Testimony to the Committee on Aging of the Connecticut General Assembly  
Supporting HB 5337: An Act Establishing a Task Force to Evaluate the Utility of  
Creating a Public Retirement Plan**

Lauren Schmitz  
Research Analyst  
Schwartz Center for Economic Policy Analysis (SCEPA)  
The New School  
*March 6, 2012*

Thank you to members of the Committee on Aging for the opportunity to testify today. I am Lauren Schmitz, a Research Analyst at the Bernard L. Schwartz Center for Economic Policy Analysis (SCEPA) at The New School in New York. Our work focuses on the public economics debate surrounding the role government can and should play to raise living standards and create economic security. Our director, Teresa Ghilarducci, is one of the nation's leading economists on retirement security and a highly visible advocate for pension reform. Today I am going to speak to you about SCEPA's State Guaranteed Retirement Account (GRA) proposal that aims to expand retirement security at the state level by giving workers who currently lack access to a retirement plan through work the option to invest in a retirement plan administered by the state pension fund. This proposal is already being considered in the California legislature.

-----

Traditionally, American retirement income has been based on a pyramid of layered income sources: the bedrock and the base of retirement income is Social Security, the middle-tier is employer-sponsored retirement plans, and at the top of the pyramid is personal savings. Each layer is a different size for every person—low-income workers have a much larger Social Security base and fewer personal assets than higher income workers. This metaphor makes it clear that although Social Security was designed to insure only a portion of a retiree's income, it in fact often makes up a majority of that income. However, its benefits average only \$1,177 a month, too little to ensure a decent standard of living; additional savings from other sources are necessary for a comfortable retirement.

For years, many workers have relied on employer-sponsored retirement plans to supplement Social Security in retirement. But the employer-sponsored retirement system is on the decline on several fronts; in fact, most private employers do not offer any type of retirement plan at all. Medium and small firms are least likely to sponsor any kind of plan<sup>1</sup> because retirement plans, like health insurance, are a voluntary expense, and because small firms have less revenue and managerial expertise to navigate regulations and administrative burden. As a result, employer sponsorship of retirement plans has declined nationally from 61% in 2000 to 53% in 2010.<sup>2</sup> In Connecticut, the downturn in sponsorship over this same time period has been from 64% to 58%.

Even if workers do have a retirement plan through their employer, these plans have shifted from defined benefit (DB) plans, where workers were guaranteed a set payment for life based on years of service and salary, to defined contribution (DC) or individual account 401k-type plans. DC plans shift all

the risks and costs of retirement onto the shoulders of workers: they charge exorbitant fees that eat away at returns<sup>3</sup>, require workers to choose from a bewildering and opaque menu of investment options, and may be exhausted before the end of a worker's life.

All workers, whether or not they are covered by a 401(k) style plan or an individual retirement account (IRA), need a financial institution that will administer their retirement savings in an efficient, low cost way that earns a secure and sufficient rate of return and preserves savings for retirement. The policy challenge, then, is not just to expand access to individual account-based retirement plans, but to address the critical failures in the existing system to meet three key criteria for retirement income security: 1) Adequate contributions; 2) Low-cost, quality investment vehicles that are professionally managed and, ideally, shield individual workers from investment and market risks; 3) A lifetime guaranteed stream of income at retirement.

-----

In 2010, 686,425 workers in Connecticut between the ages of 25 and 64 did not have access to a retirement plan through their employer.<sup>4</sup> We propose that the Connecticut legislature restore access by giving workers who currently lack a place to house their retirement savings the option of opening up an individual, cash balance pension plan through the existing Connecticut Retirement Plans and Trust Funds (CRPTF).

A cash balance plan is officially a defined benefit pension plan that has a hybrid structure. The contributions are pooled and the employer and/or employee put a defined percentage of pay into an account. The account receives a defined rate of return usually around 3%. The final benefit is determined by the account balance and can be converted into an annuity at retirement. We propose employees and employers contribute at least 5% of pay. Taking into account Social Security benefits, a 5% contribution rate with a real return of about 3% would allow a middle income worker to replace nearly 60% of their pre-retirement income.<sup>5</sup>

We have modeled the feasibility of a 3% guarantee and found using Monte Carol simulations<sup>6</sup> that there has never been a 40-year period where a diversified portfolio earned an average annual real return of less than 3.5%. While we cannot guarantee the future, the past seems to indicate that the risk the state would bear in order to back this guarantee would be negligible. In addition, a Board of Trustees established to administer the plan would likely be given the authority to adjust the guarantee year to year to minimize any unnecessary risk. The Board would also take on any fiduciary responsibility to ensure that the retirement savings are managed in the beneficiaries' best interests.

The plan would contract with the state pension system to invest the funds. States, through their employee pension plans, already sponsor excellent financial institutions that, on a not-for-profit basis get the highest returns for the least cost. These funds pool the market and longevity risks of a large number of individuals, have the best money managers, and their bargaining power lowers Wall Street fees. The public pension fund traders are also more disciplined and have a longer-term view, which stabilizes markets and protects individuals from swings in asset prices. In short, because they pool

longevity risk, can offer a well-diversified portfolio over time, and are professionally managed, DB plans can deliver the same level of benefits as DC plans at a lower cost—46% less to be exact.<sup>7</sup>

Note that these accounts would be kept separate from public sector retirement funds. In terms of costs, since the proposal would take advantage of existing infrastructure, any administrative expenses would be minimal and paid for by participating employees and the employers, not taxpayers.

Most importantly, participation in Connecticut GRAs would raise savings rates in the state. In 2010, if the 686,425 workers in Connecticut who lacked access to a workplace retirement plan contributed 5% of their earnings, the fund would have generated approximately \$995 million in savings.<sup>8</sup>

-----

This proposal is already being considered in California. Prominent California policymakers and government officials are advocating swift action to start the work of restoring retirement security to all workers within the state. Recent remarks by California Treasurer Bill Lockyer highlighted both the need for public sector pension reform and the political advantage of linking these reforms to the demand for a meaningful retirement security option for California private sector workers.<sup>9</sup> State Treasurer Bill Lockyer lauded the state-based retirement accounts proposed here and also published in a recent California-specific report, *Meeting California's Retirement Security Challenge* (October 2011), by the UC Berkeley Center for Labor Research. As a result, California Senator Kevin de León is sponsoring a bill that would create a Personal Pension program that would pool employee and employer contributions into a professionally-managed retirement fund administered by the California Public Employees' Retirement System (CalPERS).

The bill establishes the Golden State Retirement Savings Trust Act, which would create a trust administered by the Golden State Retirement Savings Investment Board, under the State Treasurer's Office. If passed, the Board would conduct a market analysis, and if the legislative proposal is determined to be self-sustaining, develop the Personal Pension program.

The employee default savings amount for the cash balance plans would be set at 3%, and the board has the authorization to adjust the amount between 2%-4% and vary the amount according to the length of time the employee has contributed to the Personal Pension program. The employer would also be required to contribute a minimum of 1% of an employee's annual salary for the employee's first year of participation, and a minimum of 2% in the second and subsequent years of the employee's participation.

Legally, since private sector workers' retirement savings are regulated by the Employee Retirement Income Security Act (ERISA) of 1974 it would ultimately have to oversee and regulate the administration of the Golden State Retirement Savings Trust Act. ERISA has proven to be a dynamic and flexible framework which has responded to the many challenges and innovations in the retirement security marketplace. The legislative intent of ERISA is to expand employer pensions to the entire workforce and regulators have proven to help innovators reach that goal.

In closing, every worker needs a safe and convenient way to save their earnings to prevent downward mobility in retirement. SCEPA's State GRA proposal would connect private sector workers to the public sector's secure and efficient pension funds to restore retirement income security for all workers. Thank you.

---

<sup>1</sup>See the Bureau of Labor Statistics National Compensation Survey, Employee Benefits in Private Industry for information on sponsorship by firm size: <http://www.bls.gov/news.release/ebs2.t01.htm>.

<sup>2</sup>Authors' calculations from the 2001 and 2011 Current Population Survey, March Supplement.

<sup>3</sup>Hiltonsmith, Robert. 2010. "The Failure of the 401k: How Individual Retirement Plans are a Costly Gamble for American Workers." New York: Dēmos.

<sup>4</sup>SCEPA's calculation from the March Current Population Survey. Data from 2010 are two year averages from 2010 and 2011. We include only workers with positive earnings between the ages of 25-64.

<sup>5</sup>Ghilarducci, Teresa. 2011. "High Performance Pensions for All Californians." In Nari Rhee, ed., Meeting California's Retirement Security Challenge. Berkeley, California: UC Berkeley Center for Labor Research and Education, pp. 94-112.

<sup>6</sup>Stubbs, David. 2010. "Modeling a Guaranteed Retirement Account System." SCEPA working paper. <http://www.economicpolicyresearch.org/working-papers/122-modelling-a-guaranteed-retirement-account-system-in-the-united-states.html>

<sup>7</sup>Almeida, Beth, and William B. Fornia. 2008. "A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Plans." Washington, DC: National Institute on Retirement Security (NIRS).

<sup>8</sup>SCEPA's calculation from the March Current Population Survey. Data from 2010 are two year averages from 2010 and 2011. We include only workers with positive earnings between the ages of 25-64. Based on this sample, a 5% contribution of median income earnings (\$29,000) is multiplied by 686,425, or the number of workers who reported working for an employer who did not sponsor a retirement plan in 2010. This yields \$995,316,250 in savings.

<sup>9</sup>Lockyer, Bill. 2010. "California's Fiscal Future: Do We Need a Public Pension Reboot?" at the 21st Annual Northern California Public Retirement Seminar. October 13. Sacramento, CA <http://www.treasurer.ca.gov/news/releases/2011/20111013.pdf>